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BEFORE THE

DEPARTMENT OF TRANSPORTATION

WASHINGTON, D.C.

Joint Application of

AMERICAN AIRLINES, INC. and
EXECUTIVE AIRLINES, INC., FLAGSHIP
AIRLINES, INC., SIMMONDS AIRLINES, INC.,
and WINGS WEST AIRLINES, INC.
(d/b/a AMERICAN EAGLE)
and
CANADIAN AIRLINES INTERNATIONAL LTD.,
and ONTARIO EXPRESS LTD. and TIME AIR INC.
(d/b/a CANADIAN REGIONAL) and
INTER-CANADIAN (1991) INC.

: Docket OST-95-792 - 31

under 49 USC §§ 41308 and 41309 for approval of and
antitrust immunity for commercial alliance agreement

OBJECTIONS OF CONTINENTAL AIRLINES, INC.

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June 4, 1996

22 pgs

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AMERICAN AIRLINES, INC. and EXECUTIVE AIRLINES, INC., FLAGSHIP AIRLINES, INC., SIMMONS AIRLINES, INC., and WINGS WEST AIRLINES, INC. (d/b/a AMERICAN EAGLE) and CANADIAN AIRLINES INTERNATIONAL LTD., and ONTARIO EXPRESS LTD. and TIME AIR INC. (d/b/a CANADIAN REGIONAL) and INTER-CANADIAN (1991) INC.	:	Docket OST-95-792
under 49 USC §§ 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement	:	

OBJECTIONS OF
CONTINENTAL AIRLINES, INC.

In a radical departure from recent precedent and the U.S. International Aviation Policy Statement, the Department has decided tentatively to grant antitrust immunity to an alliance between American[1] and Canadian despite the following:

- Entry is restricted in all major U.S.-Canada markets and 78% of all U.S.-Canada seats in June 1996 are offered in markets where designations and frequencies are restricted.

[1] Common names of carriers are used.

- 42.6% of all U.S.-Canada passengers are carried in the U.S.-Toronto market,[2] where designations and frequencies will be tightly restricted for nearly two more years.

- Even after capacity and designation restrictions are lifted at Toronto, slot constraints will continue to limit entry and significant facility constraints are anticipated.

- The U.S.-Canada agreement lacks most attributes of "open skies" agreements and is heavily imbalanced in favor of Canadian carriers.

- Unlike other situations in which the Department has granted antitrust immunity for international alliances, granting antitrust immunity to American/Canadian will create a disincentive for other countries to enter true, immediate open skies agreements.

- If the Department were to immunize the American/Canadian agreement, a United/Air Canada agreement will follow immediately and the two largest carriers of each country will have combined forces to lock out new U.S.-flag competition.

Until Canada is willing to open its markets fully and guarantee U.S. carriers access at Toronto, the American/Canadian agreement should not be approved and given antitrust immunity.[3] If the U.S.-Canada market is as "unique" and "special" as the Department's show-cause order claims, immediate, equal and effective access for U.S. carriers should be achieved through

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[2] Source: INS data for the second quarter of 1995. Since the Department did not release recent T-100 traffic data for this proceeding, Continental has been unable to analyze current traffic information. Continental asks the Department to release these critical data before reaching a final decision in this proceeding so further comments can be submitted.

[3] Although DOT has been considering the American/Canadian application for seven months, it has given interested carriers only five business days to respond to a show-cause order making major changes in the Department's policy on antitrust immunity. Such short notice for such a major change violates carrier rights to due process.

negotiations before antitrust immunity is awarded to American/Canadian.[4]

Continental states as follows in support of its objections to the Department's tentative decision in Order 96-5-38:

I. APPROVING THE AMERICAN/CANADIAN AGREEMENT AND GIVING IT ANTITRUST IMMUNITY WOULD VIOLATE THE DEPARTMENT'S POLICIES AND PRECEDENTS

When the Department tentatively approved the United/Lufthansa alliance and proposed giving that alliance antitrust immunity, the Department said:

> . . . the U.S. Germany Open Skies accord would permit any U.S. airline to serve Germany from any point in the United States. Accordingly, all U.S. airlines will have the opportunity and ability to enter the U.S.-Germany marketplace and to increase their service if the alliance partners attempt to raise prices above competitive levels (or lower the quality of service below competitive levels).

(Order 96-5-12 at 23; see also, Order 92-11-27 at 13-14, 15). In sharp contrast, the U.S.-Canada agreement prohibits open access for U.S. carriers in markets representing 78% of the transborder seats. The Department's show-cause order itself says "an open skies agreement, even where it is also a de facto open entry market, is a necessary, but not automatically sufficient, basis for the grant of antitrust immunity" (Order 96-5-38 at 16), but the Department is now proposing

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[4] Although other carriers answered the American/Canadian application and argued cogently that approval should not be granted, Continental did not comment earlier because it believed the Department's policies and principles were clear: without open skies or its functional equivalent, no antitrust immunity would be granted, and the U.S.-Canada agreement clearly provided for neither open skies nor a functional equivalent. Since the Department's tentative approval would violate the Department's policies and adversely affect both transborder and global competition, Continental is constrained to object now.

to abandon that principle since the U.S.-Canada market is neither de facto open-entry nor subject to a true "open skies" agreement at this time.

While the existence of opportunities for new U.S.-flag competitors to enter the market and compete with immunized alliances is itself absolutely critical to assuring competition despite a grant of antitrust immunity, the Department's global aviation policy is also based on the proposition that granting immunity only for "open skies" agreements will encourage other countries to open their skies. The Department established U.S. policy when it approved the Northwest/KLM agreement and said,

> We look to our Open Skies Accord with the Netherlands and our approval and grant of antitrust immunity to the Agreement to encourage other European countries to agree to liberalize their aviation services so that comparable opportunities may become available to other U.S. carriers.

(Order 92-11-27 at 14) The policy worked. Other countries have followed the U.S.-Netherlands lead and adopted open skies agreements, and press reports indicate additional open skies negotiations are about to start.[5] In tentatively approving and immunizing agreements between Delta, Swissair, Sabena and Austrian, the Department recently reiterated its policy:

> It is our expectation that these accords will encourage other European countries to seek similar liberal aviation agreements with us. Since, under the open skies agreements, the price and service quality of U.S.-Austria,

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[5] See "Alliances, Antitrust Immunity Prod French to Set Talks With U.S.," Aviation Daily, June 3, 1996 at 367.

> Belgium and Switzerland airline service will be disciplined by market forces, rather than by restrictive bilateral agreements, U.S.-Europe travelers will have an incentive to choose the airline services available on routes from the United States to Austria, Belgium, and Switzerland (as well as our other Open Skies partners) and beyond, instead of other transatlantic routes.

(Order 96-5-26 at 3-4) Similarly, in tentatively immunizing the United/Lufthansa alliance, the Department said granting the application would benefit the public interest by "encouraging a further liberalization of the transatlantic and global marketplace." (Order 96-5-12 at 31)

In instances in which other governments have raised the possibility of antitrust immunity for alliances during open-skies negotiations, the Department has indicated that each alliance must be considered on its own merits. Nonetheless, the Department has been clear and consistent in indicating that "an open skies agreement . . . is a necessary, but not automatically sufficient, basis for the grant of antitrust immunity.[6] If the Department now grants immunity before achieving open skies in Canada, the credibility of U.S. negotiators will be compromised.

II. U.S.-CARRIER ENTRY INTO THE U.S.-CANADA MARKET IS HIGHLY RESTRICTED

Although there may be practical limits on entry in other markets where the Department has immunized, or proposed to immunize, alliances between carriers, only the U.S.-Canada agreement actually prohibits U.S. carriers from competing

[6] See Order 96-5-38 at 16 (emphasis added).

effectively in alliance markets. Toronto constitutes 42.6% of the U.S.-Canada passengers (40% of the U.S.-Canada seats), and both designations and frequencies at Toronto are limited until February 27, 1998. Similarly, the Vancouver and Montreal markets, which together constitute 38% of the U.S.-Canada seats (33% of the passengers), are subject to designation and frequency limits until February 27, 1997.[7] The Department's linguistic gymnastics suggesting the U.S.-Canada market is "really" open despite these limitations cannot pass muster. What is "unique" about Canada isn't the length of the border, the number of passengers transported or the number of open markets, but rather the Department's proposing to grant immunity despite the fact that access to all three major Canadian cities is restricted. With access to transborder markets comprising 78% of the transborder seats restricted, the Department must not permit a de facto merger between two carriers creating, for instance, a duopoly (American/Canadian and Air Canada) with 99% of the New York/Newark-Toronto market.[8]

Although Continental will be entering the New York/Newark-Toronto market, the U.S.-Canada agreement limits Continental to two daily flights until February 24, 1997, when the U.S. has a total of only 8 additional frequencies

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[7] Although the Department claims that the demand for routes serving both Vancouver and Montreal has been met, this claim ignores the fact that no one carrier could apply for two routes in any one year. This being so, access is constrained and carriers have not applied for routes they might otherwise have sought because of the applicable restrictions.

[8] The Chicago-Toronto market would be similarly afflicted if Air Canada and United seek antitrust immunity. See Aviation Daily, June 3, 1996 at 365.

available to award to all U.S. gateways for Toronto service added since February 24, 1995. Based on the Department's own figures in Order 96-5-26, the post-merger Hirshman-Herfindahl Index (HHI) for the New York-Toronto market is an extraordinary 5,121, and the change in the market HHI index attributable to this de facto merger is an astounding 580. Where the post-merger HHI is 1800 and the merger produces an increase of more than 100 points, it is presumed to create or enhance market power or facilitate its exercise. (See Department of Justice and Federal Trade Commission Horizontal Merger Guidelines § 1.5, 57 Fed. Reg. 14522 (1992)) In the United/Lufthansa case, TWA argued a post-merger market share in the U.S.-Germany market of 2,721 and an increase of 459 (compared to 5,121 and 580 for Newark-Toronto) should have precluded an award of immunity. The Department distinguished TWA's competition argument in the United/Lufthansa case by explaining that (1) a significant amount of U.S.-German traffic travels over third-country intermediate points, (2) an unspecified amount of U.S.-Germany onboard traffic moves between the United States and Germany and a third country and (3) Germany had agreed to eliminate frequency caps. (See Order 96-5-12 at 22, n.47). No New York-Toronto traffic moves via a third-country point and third-country traffic in this market is not sufficiently substantial to affect the HHI analysis. Most importantly, Canada has not agreed to eliminate frequency caps in the New York/Newark-Toronto market. Under these circumstances, concentration in the New York/Newark-Toronto market will be seriously impaired if Continental is unable to operate additional frequencies based

on market demand immediately upon immunization of the American/Canadian alliance.

Even if the U.S.-Canada agreement permitted additional New York/Newark-Toronto flights, slot access at Toronto is already a problem. When Continental sought appropriate slots for Houston-Toronto flights, it was offered slots only at times which would not meet its needs. Similarly, when Continental begins Newark-Toronto service this summer, it will be unable to operate at the times it originally requested because slots were unavailable at those times. Since Toronto slots cannot be bought and sold, Continental has no means of acquiring Toronto slots beyond requesting them from the slot coordinator. Despite the fact that Canadian carriers could have bought additional slots at slot-controlled U.S. airports, they were given slots at Chicago (O'Hare) and New York (LaGuardia) as part of the U.S.-Canada agreement to assure them cost-free access to airports Canadian carriers believed were critical to serving the transborder markets. Access to slots and facilities at Toronto will only get more difficult as service expands there, and the likelihood of sufficient slots and facilities being available for all U.S. carriers seeking entry after February 24, 1998 is exceedingly slim.

If entry were open at Toronto and slots were available on an open market, Continental could compete with the American/Canadian combine. Continental would offer at least six daily roundtrip flights in the New York/Newark-Toronto market, five daily Cleveland-Toronto flights and two daily Houston-Toronto flights. These new Continental flights would provide far more consumer and competitive

benefits than pooling the resources of American and Canadian could possibly provide.[9] With at least six daily Newark-Toronto flights, Continental could provide both substantial competition in the largest transborder market, New York/Newark-Toronto, and significant competition between Toronto and the cities served through Continental's Newark hub. Since Continental could then offer numerous flight options in the local market and connect Toronto with six daily connecting complexes, it would add far more competition to the New York/Newark and east coast-Toronto markets than could possibly be added by providing antitrust immunity for American/Canadian code-sharing which is already in place.

Similarly, the Cleveland-Toronto service Continental would offer would both expand service in the local market by offering large-jet and additional small-aircraft service as well as creating an additional hub competing with Chicago, Detroit and Pittsburgh for Toronto-midwest/southwest/western traffic. With appropriate slots at Toronto and synergies derived from Toronto-Newark and Toronto-Cleveland service, Continental's nonstop Toronto-Houston service could compete with the American/Canadian combine's operations at Dallas/Ft. Worth for Toronto-Texas/southwest traffic. Moreover, Continental's expanded service between Toronto and both Newark and Houston would enable it to compete with

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[9] The Department's order suggests granting immunity to American and Canadian will permit them to compete with other alliances, but there are no other alliances in the U.S.-Canada market. If this rationale were followed, the Department would then have difficulty distinguishing an alliance between Air Canada, which dominates the U.S.-Canada market, and United, one of the largest carriers in the U.S. market.

American and Canadian for the Toronto-Latin America traffic they now carry. Unless and until such opportunities are available to Continental to assure effective Toronto competition despite an immunized American/Canadian alliance, the Department should refuse to grant antitrust immunity to the American/Canadian alliance.

III. IN ADDITION TO SEVERE RESTRICTIONS ON SERVICE AT TORONTO, MONTREAL AND VANCOUVER, THE U.S.-CANADA AGREEMENT IS FAR FROM BEING A TRUE "OPEN SKIES" AGREEMENT IN OTHER IMPORTANT RESPECTS.

The Department's definition of "open skies" for purposes of international aviation bilateral negotiations contains 11 "core elements,"[10] most of which are absent in the U.S.-Canada agreement. The core elements which are not met in the U.S.-Canada market are:

(1) Open entry on all routes. As noted above, Canada allows open entry for U.S. carriers only in markets comprising 22% of U.S.-Canada seats.

(2) Unrestricted capacity and frequency on all routes. Canada restricts capacity and frequency at Canadian cities accounting for 78% of all U.S.-Canada seats.

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[10] See In the Matter of Defining "Open Skies", Order 92-8-13. Although the definition was established for purposes of negotiating open skies agreements with European countries, the Department cited this open skies definition order in Order 96-5-26 and has developed no other definition for other areas of the world. If in fact the Department is developing another definition for Canada, it should use the same process used in establishing its initial definition rather than making an ad hoc judgment in this proceeding.

(3) Unrestricted route and traffic rights, that is, the right to operate service between any point in the United States and any point in the [other] country, including no restrictions as to intermediate and beyond points, change of gauge, routing flexibility, coterminalization, or the right to carry Fifth Freedom traffic. U.S. carriers may not offer unrestricted service between U.S. and Canadian points, no Fifth-Freedom rights for intermediate or beyond services are permitted, flights serving points behind the U.S. must have separate numbers, and coterminalization is prohibited for all-cargo flights.

(4) Liberal charter arrangement (the least restrictive charter regulations of the two governments would apply, regardless of the origin of the flight). Although Canada has substantially liberalized its own charter rules, it has not agreed to apply whichever country's rules are less restrictive, and country of origin rules continue to apply.

(5) Liberal cargo regime (criteria as comprehensive as those defined for the combination carriers). As noted by the Department's own

show-cause order, the all-cargo regime is restrictive since coterminalization rights have been denied for all-cargo services.[11]

(6) Open code-sharing opportunities. Code-sharing for interior points in both countries is restricted at Toronto, Vancouver and Montreal, the most important traffic-generating cities in Canada, and no code-sharing with third-country carriers is permitted.

Although the U.S.-Canada agreement may have reasonable provisions in other areas essential to the definition of an open skies agreement, the most critical elements are missing. While the Department said it would "accept that in some contexts the phasing in of certain aspects of our definition might not be inconsistent with the overall notion of an open-skies agreement" (Order 92-8-13 at 7), the Department is now considering a delayed phasing-in of some of the most critical provisions as well as the absence of many "core elements." Moreover, the Department committed itself to evaluating "public interest considerations, including factors in an individual case that could seriously affect the ability of U.S. carriers to realize the benefits of an open-skies agreement, such as access to key

[11] The Department's proposal to deny antitrust immunity for the applicants' all-cargo services to secure leverage for elimination of this restriction is of little relevance since neither applicant offers transborder all-cargo flights. If the same principle were applied to combination service, however, the applicants could not receive immunity for any services at Toronto, Vancouver or Montreal. Surely, the inability to add services in these markets is a far greater inhibitor of competition than the inability to coterminalize services using all-cargo aircraft. Put another way, if Continental were permitted to operate unlimited Newark/Cleveland-Toronto services but could not coterminalize them with other points in Canada, it would be far better off than it is today.

airports." (Id.) Without assuring effective access to slots and facilities at Toronto, even the market-opening opportunities scheduled for February of 1998 could prove illusory.

IV. ABANDONING THE OPEN SKIES PREDICATE TO GRANT ANTITRUST IMMUNITY TO AMERICAN/CANADIAN WILL JEOPARDIZE THE U.S. OPEN SKIES EFFORT THROUGHOUT THE WORLD

Immunizing the American/Canadian alliance despite the extraordinary limitations on U.S.-carrier services will discourage other countries from entering open skies agreements. If Canadian airlines can secure antitrust immunity despite the limitations placed on U.S. airline services, other countries will seek to do so as well, making the U.S. negotiating position for true open skies agreements untenable (or at least extremely difficult) since the precedent of considering antitrust immunity only for countries which agree to open skies will have been reversed. If immunity for American/Canadian is acceptable before Toronto, Montreal and Vancouver are open, can approval for British Airways and American or another large U.S. carrier be acceptable before London (Heathrow) is opened? Could immunity be granted to a Japanese carrier without opening Tokyo and Osaka? Continental believes none of these is acceptable.

The Department's efforts to distinguish the U.S.-Canada market cannot hide the fundamental fact that granting antitrust immunity to American/Canadian is tantamount to abandoning open skies as a prerequisite for granting antitrust immunity. Without an "open skies" prerequisite for antitrust immunity, a primary

incentive for foreign countries to accept open skies agreements will have been eliminated. Only by insisting on true market-opening measures in Canada before approving antitrust immunity can the U.S. implement a less-anticompetitive alternative to the proposal before it and continuation of the restrictive bilateral regime. At the same time, insisting on market-opening measures will assure that other countries know that they must agree to true open skies agreements before antitrust immunity will be given to their carriers' alliances.

The Department says, "Absent this near-term satisfaction of entry needs and the certainty of complete entry liberalization in so short a period, we would not grant antitrust immunity for the U.S.-Toronto routes." (Order 96-5-38 at 15) As Continental has demonstrated above, its own "near-term . . . entry needs" certainly will not be met before 1998 if the Department does not require market-opening measures before granting antitrust immunity to the American/Canadian alliance, and the likelihood that Continental's needs will be met after 1998 is extremely slim, based on difficulties Continental has already experienced in securing slots at Toronto.[12] The Department cites Air Canada's dominance of the U.S.-Canada market as a justification for its approval of an immunized American/Canadian alliance prior to opening up of the major transborder markets,

[12] Moreover, Canada's border with the United States and the alternative surface transportation available are by no stretch "unique." Similar conditions exist in the U.S.-Mexico aviation relationship, which is actually more open in fact than the U.S.-Canada relationship since Mexico imposes fewer limitations on access between major U.S. and Mexican cities.

but the Department cannot ignore the inevitability that an Air Canada/United alliance appears to be awaiting the Department's decision here establishing a precedent for immunized transborder alliances.

Although the Department of Justice and the Department would impose extremely-limited restrictions on the immunity granted the applicants with respect to New York-Toronto full-fare local passengers, such a restriction will be meaningless. Such limited restrictions may make sense in U.S.-Europe long-haul markets where passengers have numerous alternative gateways in open skies countries and carriers rarely operate more than one daily frequency in each market. Between Toronto and New York/Newark, however, the numerous nonstop flights are less than an hour and a half long, while the only connecting flights offered in the Official Airline Guide require at least four hours travel time. Moreover, any alternative gateways are not open; instead, they are restricted as to designations and frequencies. Without at least assuring an opportunity for Continental to compete freely in the Newark-Toronto market, no antitrust immunity should be given to American/Canadian in the New York-Toronto market. The entire New York-Toronto market should be excluded from any immunity granted, not just local full-fare passengers. If foreign countries see an opportunity to protect entry into their largest U.S. markets and key hubs of their own carriers while securing antitrust immunity for their own carriers' alliances, the U.S. will be unable to negotiate true, immediate open skies agreements and

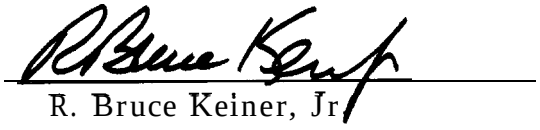
the cause of competition will have taken a giant step backwards.[13] Instead of moving backwards, the Department should negotiate an immediate opening of the transborder skies before granting American/Canadian any immunity. If U.S. carriers must wait for an opening of the U.S.-Canada market, the applicants must also wait for antitrust immunity.

V. CONCLUSION

The Department should reverse its tentative decision and refuse to grant antitrust immunity to the American/Canadian alliance until Canada has agreed to adequate immediate measures to assure effective transborder competition in the largest U.S.-Canada markets, offsetting the market power the American/Canadian alliance would hold if it were to be immunized from the antitrust laws.

Respectfully submitted,

CROWELL & MORING

By: 
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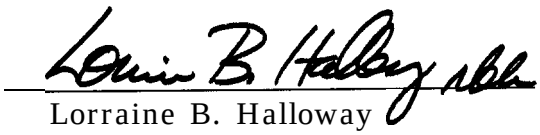
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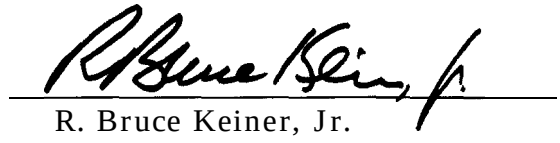
June 4, 1996

[1272933]

[13] This precedent will be particularly difficult to avoid when insisting on open skies in the U.S.-U.K. market, where London service, particularly at Heathrow, remains severely restricted while smaller cities have been opened to new service.

CERTIFICATE OF SERVICE

I certify that I have this date served a copy of the foregoing objections upon all parties to this proceeding in the manner specified in Order 96-5-26.



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